the U.S. dollar as the reserve currency. An investor (foreign or domestic) decides to invest $2 million in a country with a currency board. To buy the local goods, machines and labor required for the investment, the investor needs the local currency and to that end, hands over $2 million to that country's currency board. In exchange, the local currency board gives the investor local currency (say, pesos) at the rate established by the fixed exchange rate (say, 2 pesos per dollar). In other words, the currency board gives the investor 4 million pesos of the currency board's money in exchange for the investor's $2 million. This currency board money is nothing but the bills and coins people carry in their wallets. These bills and coins are actually the currency board's liabilities—that is, upon demand the currency board must exchange those bills and coins for the reserve currency.

Part of the fiduciary money issued by the currency board will remain in the public's wallets, but the rest will be deposited in commercial banks. Those bills and coins (that is, the currency board's liabilities in the form of money) in the banks become the commercial banks' cash reserves, which they use to make loans and create deposits through the standard money multiplier.

Chart 1 depicts a hypothetical economy in which half the money created by the currency board stays in the public's wallets and the rest is deposited in commercial banks. Typically, the public withdraws only a fraction of the banks' cash reserves on any given day. In this example, banks must satisfy, on average, daily cash withdrawals of only half their cash reserves, or 1 million pesos. One million pesos, then, would be left idling in the banks' vaults. Of course, profit-driven bankers will lend that money by opening accounts against which borrowers can issue checks for up to 2 million pesos.

In this example, total deposits in the banking system after the loans